MANAGER'S BUDGET ADDENDUM #37

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Larry D. Lisenbee

SUBJECT: **GENERAL FUND EXPENDITURES GROWING FASTER THAN PROJECTED REVENUES**

DATE: June 7, 2007

Approved /s/ Date 06/08/07

BACKGROUND

This memorandum is prepared in response to the Mayorõs March Budget Message for 2007-2008 which directed the administration to identify all elements of General Fund projected expenditures that are growing faster than projected revenues.

ANALYSIS

To address this referral, the 2008-2012 General Fund Five-Year Forecast, which was released in February 2007, was analyzed to compare the projected growth rates of revenues and expenditures to determine which expenditure categories are expected to experience a rate of growth that outpaces revenue growth. On an overall basis, in each of the next five years, expenditure growth is projected to exceed revenue growth. As shown in the table below, the projected average total growth rate in revenues of 3.66% is not sufficient to meet the projected total expenditure growth rate of 4.52%.

2008-2012 General Fund Forecast
Projected Revenue and Expenditure Growth

	2008-2009	2009-2010	2010-2011	2011-2012	Average Growth
Revenue % Growth*	2.97%	4.11%	3.80%	3.74%	**3.66%**
Expenditure % Growth**	5.31%	4.80%	3.81%	4.15%	**4.52%**

* Excludes Beginning Fund Balance. Assumes continuation of the Emergency Communication System Support Fee (ECSS) in 2010-2011. Actual 2008-2012 General Fund Forecast document published for that year actually reflects 0.90% growth due to the assumption of an ECSS Fee Sunset.

** Includes Committed Additions (expenses associated with maintaining and operating new public facilities)

When the expenditure trends were broken out and analyzed by category, as summarized in the table below and discussed in detail in Attachment A, it was determined that half of the expenditure categories (Personal Services, Capital Projects, Contingency Reserve, and Committed Additions) have projected average growth rates that exceed the average revenue growth rate over the next five years. The remaining expenditure categories (Non-Personal/Equipment, City-Wide Expenses, Transfers, and Earmarked Reserves) have projected average growth rates that are below the average revenue growth rate over that same period.

2008-2012 General Fund Forecast
Comparison of Projected Revenue and Expenditure Growth by Category

	2008-2009	2009-2010*	2010-2011	2011-2012	Average Growth
Revenue Growth	2.97%	4.11%	3.80%	3.74%	**3.66%**
Expenditure Categories Growing Faster Than Revenue Growth					
Personal Services	5.45%	4.38%	4.41%	4.43%	**4.67%**
Capital Projects	48.49%	0.60%	3.92%	3.77%	**14.12%**
Contingency Reserve	4.80%	4.36%	3.47%	3.80%	**4.11%**
Committed Additions	231.21%	82.47%	49.78%	9.46%	**93.23%**
Expenditure Categories Growing Slower Than Revenue Growth					
Non-Personal/Equipment	0.00%	6.21%	(1.04%)	3.41%	**2.15%**
City-Wide Expenses	2.59%	2.04%	2.07%	2.15%	**2.21%**
Transfers	4.15%	0.00%	(8.20%)	2.59%	**(0.37%)**
Earmarked Reserves	0.00%	0.00%	0.00%	0.00%	**0.00%**

As expected, our analysis indicates that Personal Services costs, which account for approximately two-thirds of the General Fund Budget, are the largest factor driving expenditure growth to levels exceeding revenue growth rates, and is therefore the primary driver of the forecasts for continued shortfalls for the next few years in the Forecast. In the Forecast, Personal Services costs are broken down into three major components (Salaries and Other Compensation, Retirement, and Health and Other Fringe Benefits). Factors that impact this expenditure category include scheduled step increases, negotiated salary cost-of living and benefit adjustments, and retirement plan actuarial studies. The Committed Additions line item deals with the additional operating maintenance cost obligations associated with in progress or planned capital improvement projects (e.g. Fire Stations, Branch Libraries, Park Community Centers). This category is the second most significant driver, at least for the next four years, of continued shortfall projections. With the addition of new libraries, community centers, and public safety facilities funded by General Obligation Bonds, the Committed Addition line item reflects significantly larger growth than would typically be anticipated. Once the General Obligation

Bond projects are completed, the growth rate in this category is expected to decline significantly. Since the Contingency Reserve is calculated at 3% of projected General Fund expenditures, this category will exceed the projected revenue growth as long as the overall expenditures are exceeding revenue growth. The last four categories (Non-Personal/Equipment, City-Wide Expenses, Transfers, and Earmarked Reserves) are expected to growth at a slower rate than revenue growth, helping to partially offset the impact of those expenditure categories that are growing at a faster rate.

Additional detail on each expenditure category is provided in Attachment A, including the growth by fiscal year, the average growth over the five-year period, a brief discussion of the assumptions that were used in the development of the 2008-2012 General Fund Forecast, and the identification of key drivers in particular expenditure categories.

As discussed in the 2008-2012 General Fund Forecast, caution is in order when considering the significance of the revenue and expenditure projections. Given the decreasing level of precision to be expected in the later years of a multi-year forecast, the projections in the out years should be considered in terms of the relative size of the decrease or increase from the prior year. This information helps provide a multi-year perspective to budgetary decision-making and identifies trends. It should not, however, be considered a precise prediction of what will occur. The assumptions in the out-years of the forecast will be thoroughly analyzed and updated for the preliminary forecast that will be released next fall and the final 2009-2012 Forecast that will be released in winter 2008.

/s/
LARRY D. LISENBEE
Budget Director

Attachment